United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-1293

B/P/S

United States Court of Appeals
FOR THE SECOND CIRCUIT

Docket No. 74-1293

Calendar No. 65

HARRY LEWIS,

Plaintiff-Appellant,

—against—

GEORGE L. VARNES,

Defendant-Appellee,

and

ELI LILLY AND COMPANY,

Defendant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANT-APPELLEE GEORGE L. VARNES

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TABLE OF CONTENTS

AUTHORITIES CITED

Cases:

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Statement of the Case

This is an appeal by plaintiff-appellant from a judgment entered on January 7, 1974 in the United States District Court for the Southern District of New York granting defendant-appellee George L. Varnes summary judgment pursuant to an order and opinion of Judge Pollack dated January 4, 1974 (18a-23a*). The complaint (3a-6a) contained two claims; the first alleging a violation by Mr. Varnes of Section 16(b) of the Securities Exchange Act of 1934 (the "Act") by reason of the exercise of stock options after his retirement as a director and

*Numerical references in parentheses followed by "a" are to pages of the Appendix, those preceded by "Exh." are to pages of the Exhibit Volume, and those preceded by "Pl. Br." are to pages of the brief of plaintiff-appellant.

officer of Eli Lilly and Company and the subsequent sale of a portion of his shares within six months, and the second alleging a violation by him of Section 10(b) of the Act by reason of the same transactions.

The order and opinion of Judge Pollack (18a-22a) granted summary judgment to Mr. Varnes on the Section 16(b) claim on the ground that the sales in issue were exempted from Section 16(b) liability by rules of the Securities and Exchange Commission. It dismissed the Section 10(b) claim for failure to allege facts with particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure. Although plaintiff was given leave to replead the Section 10(b) claim upon a proper factual showing of, or upon a full and sufficient assertion of information and belief concerning, the alleged use of inside information by Mr. Varnes, plaintiff did not do so. Plaintiff makes no argument on this appeal concerning the propriety of the dismissal of the Section 10(b) claim by the court below.

The opinion of the court below is reported at 368 F. Supp. 45 (S.D.N.Y. 1974).

Statement of Issues

1. Does Section 16(b) of the Act apply to the purchase of stock by a retired director and officer after resignation from all positions, and the subsequent sale of shares within six months?

2. Are sales of stock made by a retired director and officer which need not be reported under Section 16(a) of the Act and SEC Rule 16a-1, because they were made more than six months after the last pre-retirement transactions, exempted from Section 16(b) liability by reason of SEC Rule 16a-10?

3. Does Section 23(a) of the Act preclude the imposition of Section 16(b) liability for sales made by a retired director and officer in conformity with SEC Rules 16a-1 and 16a-10 and pursuant to advice given him by his counsel and the counsel for the issuer.

Plaintiff also raises an issue concerning the validity of SEC Rule 16b-6 notwithstanding that this Court has determined in another case that such Rule is a valid exercise of power by the Securities and Exchange Commission.

Statutes Involved

The following sections of the Securities Exchange Act of 1934 and rules issued pursuant thereto are involved on this appeal: Sections 16(a), 16(b) and 23(a) of the Securities Exchange Act of 1934, and Rules 16a-1, 16a-10 and 16b-6 of the Securities and Exchange Commission. These sections and rules are reproduced in the addendum to this brief.

Statement of the Facts

Throughout the period 1940 to the end of January, 1971 appellee Varnes was employed by Eli Lilly and Company ("Lilly"), beginning as a salesman and, at the time of his retirement, holding the positions of group vice president and director (9a*). On January 31, 1971, Mr. Varnes resigned from all offices he held with Lilly and since that time has had no employment or consultant contracts with Lilly, nor has he participated in Lilly's business or been consulted by it (9a, 11a, 12a).

Mr. Varnes' Stock Options and Their Exercise

As part of his remuneration, Mr. Varnes, along with a number of other Lilly employees, was granted stock options pursuant to Lilly's stock option plans. On four occasions during the period January 20, 1967 through May 18, 1970, Mr. Varnes received a grant of a stock option to purchase shares of Lilly common stock (10a, Exh. 1-29). As a result of the four stock option grants and a stock split in the latter part of 1968, Mr. Varnes,

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*The stipulated facts on which the case was submitted to the court below are contained on pages 9a through 17a of the Appendix and in the Exhibit Volume.

in December, 1970, had the right to purchase 23,000 shares of Lilly common stock at prices ranging from $44.75 a share to $87.50 a share (10a, Exh. 30-33). In addition, he owned 12,000 shares of Lilly common stock that were unrelated to those stock options (10a).

In 1970 Mr. Varnes, partly for reasons of health, decided that he would retire from his employment with Lilly (11a-12a). In December, 1970, he considered what he would do with respect to his stock options which by their terms expired two months after retirement (12a). Since the price of shares of Lilly common stock in the latter part of 1970 had ranged from $77 to $104, it was clear to Mr. Varnes that he would exercise some, if not all, of his options. Mr. Varnes realized that if he were to exercise all his options, he would have to borrow a substantial sum of money. Since he did not wish to maintain a large interest-bearing debt, Mr. Varnes contemplated that if he incurred such debt in order to exercise his options, he would sell sufficient shares to discharge it as soon as he was no longer subject to the restrictions of Section 16(b) of the Act (12a).

Mr. Varnes did exercise all his options. On December 22, 1970, shortly before his retirement, he purchased 1,600 shares of Lilly common stock pursuant to his 1967 option. This was the last transaction in Lilly stock engaged in by him before his retirement. On February 2, 1971, following his retirement, Mr. Varnes purchased 14,400 shares of Lilly common stock under the 1967 and 1968 options. Finally, on March 26, 1971 Mr. Varnes purchased 7,000 shares of Lilly common stock pursuant to his 1969 and 1970 options (13a, Exh. 40-43). The exercise prices of the options ranged from $30.50 to $65.25 a share below the market prices of the shares at the time of exercise (13a).

Mr. Varnes borrowed approximately $653,000 from the American Fletcher National Bank and Trust Company in order to finance these purchases, and, at the time of the borrowing, he told the bank that he intended to repay the debt as soon as he was free to sell some shares without violating the provisions of Section 16(b) of the Act (13a).

The Advice Received by Mr. Varnes Concerning His Obligations Under Section 16(b)

During Mr. Varnes' employment, it was the practice at Lilly for Mr. Bradley, its General Counsel, to advise executive employees, including Mr. Varnes, of their rights and responsibilities under the federal securities laws (11a). In 1968, in connection with one such briefing, Mr. Varnes asked Mr. Bradley whether the provisions of Section 16(b) of the Act were applicable to an ex-director or officer following retirement (11a).

In reply, Mr. Bradley sent Mr. Varnes a memorandum which, citing Professor Loss, suggested that Section 16(b) did not apply to an ex-director or officer because a rule of the Securities and Exchange Commission ("SEC") (SEC Rule 16a-10, 17 C.F.R. § 240.16a-10) exempted transactions, such as post-employment purchases or sales, that were exempted from the reporting requirements of Section 16(a) (11a, Exh. 34). The memorandum stated (Exh. 34):

> "One of the leading writers in the securities field states that 'it may be a bit more difficult to justify holding a person who had no access to inside information at the date of the second transaction than one who had no access at the date of the first.' II Loss, *Securities Regulation*, p. 1061 (sec. Ed. 1961). He contends that the application of Section 16(b) seems foreclosed by the Commission's rule which exempts from Section 16(b) any transaction exempted from reporting under Section 16(a). That rule does not help one who *becomes* a director between the dates of the two transactions, because the reporting rule requires a filing with respect to any sale (or purchase) after a person becomes a director or officer even if the security was purchased (or sold) earlier. But no reports are required for transactions *after* a person ceases to be an officer, director or 10% beneficial owner."

Nevertheless, since no court had then determined the question and because of the severe penalty imposed by Section 16(b),

Mr. Bradley advised caution. His memorandum admonished (Exh. 34):

> "In light of the harsh results which may arise from violations of Section 16(b) and the absence of a controlling decision, it would seem prudent to assume that a purchase or sale after you cease to be an officer or director may be matched against a sale or purchase effected during the time you are an officer or director and within the six month period."

In April, 1969, Mr. Varnes received from Mr. Bradley a copy of a memorandum clarifying the 1968 memorandum concerning Section 16(b) (11a, Exh. 35-36). This later memorandum advised Mr. Varnes that this Court* had determined that a post-employment transaction will be matched with a transaction effected less than six months earlier if the earlier transaction occurred during the period of employment as director or officer. The memorandum stated (Exh. 36):

> "If a director or officer purchases or sells Lilly common stock before he retires and after retirement within six months effects a matching transaction, he would be liable for short-swing profits. Section 16(b), of course, is not applicable unless one of the matching transactions (purchase or sale) was made at the time you were a director or officer of the company."

Subsequently, in March, 1970, Mr. Varnes received a third memorandum from Mr. Bradley (11a, Exh. 37-39). That memorandum advised Mr. Varnes that pursuant to this Court's decision in the *Feder* case the SEC had amended SEC Rule 16a-1 (17 C.F.R. § 240.16a-1) to require the filing of a Form 4 in certain cases after a person ceased being a director or officer.

**Feder* v. *Martin Marietta Corp.*, 406 F. 2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970).

Attached to Mr. Bradley's memorandum was a memorandum from Mr. Croner, a Lilly attorney, and a copy of the SEC amended regulation (11a, Exh. 38-39). The Croner memorandum summed up the decision in the *Feder* case as follows (Exh. 38):

> "The United States Court of Appeals for the Second Circuit has held that liability for 'short-swing' profits may be incurred under the Securities Exchange Act of 1934 by a retired member of the board of directors or a retired officer if such profits are realized within six months after a matching transaction made while he was a director or officer. Therefore, if a director or officer purchases or sells Lilly stock before he retires and after retirement within six months effects a matching transaction, he would be liable for short-swing profits."

The Croner memorandum also referred to the amendment of SEC Rule 16a-1, noting (Exh. 38):

> "Following the decision of the Court of Appeals, the SEC amended its rule relating to the filing of Form 4 (Statement of Changes in Beneficial Ownership of Securities) to require in certain cases the filing of that form for transactions occurring after a person ceases to be a director or officer. The amended rule requires that Form 4 must be filed for any change in beneficial ownership of Lilly stock that occurs within six months after a change that occurred while a person was a director or officer. This reporting requirement continues so long as changes occur that are within six months of other changes that occurred before a person ceased to be a director or officer. *See*, Reg. 240.16a-1, attached."

The Advice Mr. Varnes Received Subsequent to His Retirement Relating to the Expiration of His Obligations Under Section 16(b) of the Act

Before selling any Lilly stock after his retirement, Mr. Varnes consulted with his attorney, Elmer E. Lyon, Esq., con-

cerning when he would be free of the restrictions of Section 16(b) of the Act (13a-14a). As a further precaution, Mr. Varnes requested the advice of the SEC in a letter dated June 3, 1971 which asked for the SEC's opinion (14a, Exh. 44-46):*

> "as to the earliest date on which I may sell shares of certain common stock of Eli Lilly & Co. purchased by me as a result of the exercise of certain qualified stock options granted to me while I was an officer and director of Eli Lilly & Co. so as not to come with[in] the provisions of Section 16(b) of the Exchange Act requiring the repayment of any profit from such sale."

In his letter, Mr. Varnes expressed his belief that by reason of the provisions of Sections 16(a) and (b) of the Act, he was free to sell his Lilly stock after the expiration of the six months from the last purchase of such stock while he was still a director or officer of Lilly. His letter stated (Exh. 45):

> "It is my view and opinion that under the provisions of Section 16(a) and 16(b) profits may be recovered from any 'insider' only if a purchase and sale takes place within a six months period when either the purchase or sale of stock was at a time when the person was an officer or director of the issuer and that in order to avoid the provisions of Section 16(b), I must not make any sale of Eli Lilly common stock during a six month period commencing from December 22, 1970 (the date of the last purchase while I was an officer and director of Eli Lilly & Co.) or not earlier than June 23, 1971."

The SEC, however, declined to deal with Mr. Varnes' request for an informal opinion because the enforcement of civil liability under the Act was the responsibility of the courts (14a, Exh. 47). Following the SEC's refusal to give any opinion, Mr. Varnes was advised by Mr. Lyon that he had spoken with Mr. Bradley and that both were of the opinion that any impediment under

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*A copy of the letter was sent to Mr. Bradley, Lilly's General Counsel (Exh. 46).

Section 16(b) of the Act to the sale of Mr. Varnes' stock expired on June 22, 1971, six months following his last purchase of such stock while still employed by Lilly (14a).

The Sales in Issue

Relying on the advice concerning the Act and the SEC rules he had received from both the Lilly legal department and his own personal attorney, Mr. Varnes sold 6,300 shares of his Lilly stock on July 6, 1971, more than six months after his last purchase of any Lilly stock while still an employee of that company (14a, 15a). The shares sold by Mr. Varnes were less than 20% of the shares he owned at the time (10a, 13a, 15a) and he sold no other shares in 1971. The proceeds of sale were used by him to repay his debt to the bank and for the payment of his taxes (14a).*

The total net proceeds of the sale of Mr. Varnes' 6,300 Lilly shares was $781,631.29 (14a). Since the lowest price at which Lilly shares sold on the New York Stock Exchange during the period January 6, 1971 through January 6, 1972 was $100 a share (or $630,000 for 6,300 shares), the amount in issue for purposes of this action is $151,631.29 (16a). SEC Rule 16b-6, 17 C.F.R. § 240.16b-6.

ARGUMENT

POINT I

Section 16(b) of the Act does not apply to a purchase of stock by a former director and officer and the subsequent sale of such stock within six months.

Plaintiff claims that the draconian coverage of Section 16(b) should apply to a former director or officer who, after retire-

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*As a result of Mr. Varnes' sales before the expiration of a three-year holding period, Lilly became entitled to the unanticipated benefit of a deduction for tax purposes of approximately $220,000 (the amount on which Mr. Varnes paid ordinary income tax by reason of the sales) even though it had made no payments to Mr. Varnes. Mr. Varnes' aversion to having a large debt outstanding was such that he preferred selling some of his shares and paying a large tax thereon to continuing the debt (15a).

ment, exercises stock options earned through years of service which are about to expire and sells part or all of the shares so purchased within six months thereafter. In the only two cases which have passed on this question, both the court below and the court in *Levy* v. *Seaton,* 358 F. Supp. 1 (S.D.N.Y. 1973), concluded that such transactions are exempt from Section 16(b) liability (POINT II, *infra,* p. 18).

In relevant part, Section 16(b) provides (15 U.S.C. § 78p(b)):

> "(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer . . . within any period of less than six months, . . . shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months."

The words "such . . . director or officer" require reference to Section 16(a) for their meaning. That Section provides in relevant part (15 U.S.C. § 78p(a)):

> "(a) Every person . . . who is a director or an officer of the issuer of such security, shall file . . . within ten days after he becomes such . . . director, or officer, a statement with the Commission . . . of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission . . . a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

Section 16(a) makes clear that "such . . . director or officer" subject to Section 16(b) refers to a person "who is a director or an officer." *Heli-Coil Corp.* v. *Webster,* 222 F. Supp. 831, 836 (D.N.J. 1963), *modified on other grounds,* 352 F.2d 156 (3d Cir. 1965); *cf. Feder* v. *Martin Marietta Corp.,* 406 F.2d 260, 268 (2d Cir. 1969), *cert. denied,* 396 U.S. 1036 (1970). A director or officer must file a statement of his ownership of equity securities with the SEC on assumption of office and subsequent monthly reports of changes of ownership. As plaintiff's brief concedes (p. 13) and the above-quoted language indicates, Sections 16(a) and 16(b) are complementary in that there is liability under Section 16(b) only with respect to transactions required to be reported by persons with a defined relationship to the issuer at the time of the transactions, namely, director, officer or ten percent owner. As the Supreme Court stated in *Blau* v. *Lehman,* 368 U.S. 403, 409 (1962):

> "The language of § 16 does not purport to impose its extraordinary liability on any 'person,' 'fiduciary' or not, unless he or it is a 'director,' 'officer' or beneficial owner of more than 10 percentum of any class of any equity security . . . which is registered on a national securities exchange."

Section 16(b) does not apply to the matching purchases and sales in issue in the instant case because Mr. Varnes was not a director or officer or ten percent holder at the dates of purchase or sale or at any time in between.

The statute has the effect of creating a conclusive presumption that a purchase and sale by a director or officer is made on the basis of inside information, *Levy* v. *Seaton, supra,* 358 F. Supp. at 5. That presumption cannot be vitiated even by irrefutable demonstration to the contrary. Actual reliance or nonreliance on inside information, motive or intent are irrelevant. *Adler* v. *Klawans,* 267 F.2d 840 (2d Cir. 1969). By reason of the objective criteria of Section 16(b) and its inexorable and mechanical application to cases within its ambit, Section 16(b) is intended to have a prophylactic effect. *Reliance Electric Co.* v. *Emerson Electric Co.,* 404 U.S. 418, 422 (1972).

Congress determined that a rule embracing both the culpable and the innocent coming within its boundaries was the best way to deter the improper use of inside information. The corollary is that Section 16(b) does not apply to transactions beyond its arbitrary limits whether or not they might involve the potentiality of misuse, or actual misuse, of inside information.* For example, even where it is demonstrated that inside information has been used, the statute does not impose liability for a sale more than six months after a purchase, or liability on an employee who is neither a director nor officer in name or fact. *Blau* v. *Lehman, supra,* 368 U.S. at 410-12; *Adler* v. *Klawans, supra,* 267 F.2d at 845.

Plaintiff's basic argument (Pl. Br. 17-18), expressed in a variety of disguises, is that this Court should disregard the language of Section 16(b), and, in order to effectuate its purpose of preventing unfair use of inside information (Pl. Br., Point I), apply the statute to any instance which it believes might involve the *possibility* of misuse of such information.** This argument, assuming, as it does, that Congress did not intend the limitations embodied in the language of Section 16(b), has been resoundingly rejected by the Supreme Court and this Court.

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*This discussion is not intended to suggest that this case involves in any way the use of inside information. In the period of more than three years from the first exercise of Mr. Varnes' options in December, 1970, to the expiration of the 20-day period allowed by the court below in which plaintiff might allege facts showing, or even information suggesting, the use of inside information by Mr. Varnes in connection with his stock transactions, plaintiff has been unable to discover any material inside information which might have been so utilized.

**Contrary to the suggestions in plaintiff's brief, Section 16(b) is not a panacea for all wrongs involved in the sale of securities on the basis of inside information. Congress has provided investors and the SEC with ample tools in addition to Section 16(b) to remedy any actual misuse of inside information. *See, e.g., Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 495 F.2d 228 (2d Cir. 1974); *Radiation Dynamics, Inc.* v. *Goldmuntz,* 464 F.2d 876 (2d Cir. 1972); *SEC* v. *Texas Gulf Sulphur Co.,* 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969). In addition, there is an expanding body of state remedies for the misuse by a director of inside information. *See, e.g., Diamond* v. *Oreamuno,* 24 N.Y.2d 494 (1969).

In *Blau* v. *Lehman*, 368 U.S. 403 (1962), the petitioner, represented by the same attorney as plaintiff here, argued in words similar to those of plaintiff's brief that Section 16(b) should apply to transactions of a partnership which had not deputed one of its members to serve as a director. Petitioner contended (368 U.S. at 411):

> "Conceding that such an interpretation is not justified by the literal language of § 16(b) which plainly limits liability to directors, officers, and 10% stockholders, it is argued that we should expand § 16(b) to cover partnerships of which a director is a member in order to carry out the congressionally declared purpose 'of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer. . . .' Failure to do so, it is argued, will leave a large and unintended loophole in the statute—one 'substantially eliminating the great Wall Street trading firms from the statute's operation.' 286 F. 2d, at 799. These firms it is claimed will be able to evade the Act and take advantage of the 'inside' information available to their members as insiders of countless corporations merely by trading 'inside' information among the various partners.
>
> "The argument of petitioner and the Commission seems to go so far as to suggest that § 16(b)'s forfeiture of profits should be extended to include all persons realizing 'short swing' profits who either act on the basis of 'inside' information or have the possibility of 'inside' information."

The Supreme Court rejected this approach because it had been rejected by the Congress, pointing out (368 U.S. at 411-12):

> "One may agree that petitioner and the Commission present persuasive policy arguments that the Act should be broadened in this way to prevent 'the unfair use of

information' more effectively than can be accomplished by leaving the Act so as to require forfeiture of profits only by those specifically designated by Congress to suffer those losses. But this very broadening of the categories of persons on whom these liabilities are imposed by the language of § 16(b) was considered and rejected by Congress when it passed the Act. Drafts of provisions that eventually became § 16(b) not only would have made it unlawful for any director, officer or 10% stockholder to disclose any confidential information regarding registered securities, but also would have made all profits received by *anyone*, 'insider' or not, 'to whom such unlawful disclosure' had been made recoverable by the company."

The Supreme Court has continued to reject efforts to extend coverage of Section 16(b) to persons not embraced by the plain meaning of its language. In *Reliance Electric Co.* v. *Emerson Electric Co.*, 404 U.S. 418 (1972), the Supreme Court refused to impose liability where, pursuant to a preconceived plan, a 13.2% holder of stock sold its holdings in two transactions, the first of which reduced such holdings to 9.96%. The Court held that the second transaction was exempt from coverage because the defendant did not come within the language of the statute. It stated (404 U.S. at 422):

> "Thus Congress did not reach every transaction in which an investor actually relies on inside information. A person avoids liability if he does not meet the statutory definition of an 'insider', or if he sells more than six months after purchase. Liability cannot be imposed simply because the investor structured his transaction with the intent of avoiding liability under § 16(b)."

The Court also disagreed with a contention of the dissenting Justices, similar to one made by plaintiff here (Pl. Br., Point II), that sales made by the ten percent owner carried the presumption of taint even after a prior sale reduced its holdings to below ten

percent. The Court refused to ignore the requirement that the seller be a ten percent owner at the time of sale, noting (404 U.S. at 424):

> "But whatever the rationale of the proviso it cannot be disregarded simply on the ground that it may be inconsistent with our assumption of the 'wholesome purpose' of the Act."

Similarly, this Court, notwithstanding its sensitive concern for a full effectuation of the Congressional policy embodied in Section 16(b), has rejected an approach that disregards the limitations of the statutory language. In *Adler* v. *Klawans, supra,* the Court admonished (267 F.2d at 847):

> "Of course, the statute cannot be extended beyond the limits of its language. . . ."

And in *Feder* v. *Martin Marietta Corp., supra,* the Court emphasized (406 F.2d at 262):

> "But the policy underlying the enactment of § 16(b) does not permit an expansion of the statute's scope to persons other than directors, officers, and 10% shareholders."

Neither the *Adler* case nor the *Feder* case support plaintiff's contention that Section 16(b) extends to a matching purchase and sale, both occurring after retirement (Pl. Br. 16). In the *Adler* case, the court relied on the difference in language between the provisions of Section 16(b) applicable to a director and to a ten percent owner. In the latter instance the statute expressly requires that the ten percent owner be such "both at the time of purchase and sale." The absence of a similar provision for a director and officer was viewed by the *Adler* court (267 F.2d at 845) as an indication of legislative intent that no similar restriction applied. The *Feder* case (406 F.2d at 266-67) applied the same principle to a purchase before and a sale after retirement.

The *Adler* and *Feder* cases give effect to the conclusive presumption flowing from a purchase or sale by a director that inside information has been used in that transaction. Given that

presumption as to either a purchase or sale, improper benefit is the necessary consequence. But the language of the statute does not permit the application of that presumption where neither the purchase nor sale occurred during the tenure of a director. Nor are there any policy considerations that would make such application desirable. After retirement, access to material inside information is not freely available and the very reason for the conclusive presumption loses its force. *Levy* v. *Seaton, supra,* 358 F. Supp. at 5.* Any actual misuse of information after retirement must be remedied under other sections of the Act and not Section 16(b).

The rule proposed by plaintiff would prohibit an ex-director or officer from ever buying and selling stock within a six-month period. Section 16(b) precludes a purchase and sale within six months. That is the *only* time reference in the statute. If the statute applied to a purchase and sale by a "former" director and officer, the coverage would continue through all time. Indeed, plaintiff argues for an extension of Section 16(b) liability for at least a full year following the retirement of a director. Plaintiff claims (Pl. Br. 14-16) that purchases or sales of stock which must be reported by an ex-director under SEC Rule 16a-1 (17 C.F.R. § 240.16a-1) should thereafter be subject to Section 16(b) for an additional six months.** Under plaintiff's argu-

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*The threat of misuse of inside information which plaintiff conjures for purposes of this case is more imaginary than real. The risk that an officer would forfeit his livelihood and resign in order to buy and sell stock on the basis of inside information was characterized by the *Seaton* court as "far fetched and not likely to occur in the ordinary course of events". 358 F. Supp. at 5.

**The 1969 amendment of SEC Rule 16a-1, extending the reporting requirements with respect to post-retirement transactions, stemmed from this Court's decision in the *Feder* case that a pre-retirement purchase should be matched with a post-retirement sale within six months. In the view of the SEC this extension was necessary to insure that *all* transactions within Section 16(b) were subject to the reporting requirements (See POINT II, *infra,* p. 18). Plaintiff attempts to bootstrap the additional reporting requirement designed to cover a purchase before and a sale after retirement into one designed to cover a purchase after retirement, and a subsequent sale that the Rule does not require to be reported.

ment, if a director purchases stock of his company on December 29 and retires on December 31, a subsequent purchase of stock on June 28 of the following year would result in coverage with respect to the June purchase until the end of December of that year. No such irrational result could have been intended by the Congress and this is further reason why there can be no Section 16(b) liability unless one of the matching transactions occurred before a director or officer retired from office.

Plaintiff's argument (Pl. Br. 19) that liability should attach because Mr. Varnes obtained his stock pursuant to stock options granted during employment is without merit. The question of liability turns on the status of the defendant, not on the source of the stock.

Plaintiff's reliance (Pl. Br. 20) on an express provision in the English Companies Bill extending its coverage to the period after the retirement of a director is misplaced. That bill imposes liability only on a showing of the actual misuse of material inside information. It is similiar to Section 10(b) of the Act and not Section 16(b). See Lipton, "Trading on Inside Information Under New English Companies Bill," 171 N.Y.L.J. No. 6 (January 9, 1974). Moreover, the need in the English bill for an express provision extending coverage into retirement indicates that such extension would not be warranted in the case of a statute, such as Section 16(b), containing no such express provision.

Plaintiff also suggests (Pl. Br. 18) that this Court should resort to bald fictions in order to hold Mr. Varnes liable. This approach has been rejected by the Supreme Court in *Blau* v. *Lehman, supra,* and in *Reliance Electric Co.* v. *Emerson Electric Co., supra,* and is not supported by plaintiff's authorities. *Colby* v. *Klune,* 178 F.2d 872 (2d Cir. 1949), held only that for Section 16(b) purposes, an officer is defined by the functions he performs and not merely by his title. *Feder* v. *Martin Marietta Corp., supra,* 406 F.2d at 269, held that there is liability for a sale of stock within six months of a purchase "if the stock were purchased by him during the time he was a director." These holdings are a far cry from construing the words "such . . . director or officer" to include someone who has no connection with the corporation at the time of the transactions. To engage in that

kind of "fiction" not only would raise fundamental questions of fair notice and due process, but also would frustrate the intent of Congress. For, had Congress intended Section 16(b) to apply to a former director or a non-director, "it would have been simple enough to say so." *Cf. Smolowe* v. *Delendo Corp.*, 136 F.2d 231, 236 (2d Cir. 1943).

POINT II

The sales in issue were exempted from Section 16(b) liability by SEC Rule 16a-10.

Mr. Varnes is not liable for the sales of his Lilly stock on July 6, 1971 for the independent reason that such sales were exempted from liability under Section 16(b) by reason of SEC Rule 16a-10 (17 C.F.R. § 240.16a-10). This Rule states:

> "Any transaction which has been or shall be exempted by the Commission from the requirements of section 16(a) shall, insofar as it is otherwise subject to the provisions of section 16(b), be likewise exempted from section 16(b)."

Since Mr. Varnes' July 1971 sales occurred more than six months after his last transaction before retirement, they were exempted from reporting by SEC Rule 16a-1 (17 C.F.R. § 240.16a-1), which in relevant part provides:

> "(e) Any person who has ceased to be a director or officer of an issuer which has equity securities registered pursuant to Section 12 of the Act . . . shall file a statement on Form 4 with respect to any change in his beneficial ownership of equity securities of such issuer which shall occur on or after the date on which he ceased to be such director or officer . . . *if such change shall occur within 6 months after any change in his beneficial ownership of such securities prior to such date.* The statement on Form 4 shall be filed within 10 days after the end of the month in which the reported change in beneficial ownership occurs." (Emphasis supplied)

SEC Rule 16a-10 is designed to prevent any imposition of Section 16(b) liability for transactions that need not be reported under Section 16(a) or the rules promulgated under that Section. Thus, in its announcment of the adoption of Rule 16a-10, the SEC stated (SEC Securities Exchange Act Release No. 4801 (February 20, 1953)):

> "On the other hand, Section 16(b) liability should not be predicated upon any transactions which are not subject to the reporting requirements of Section 16(a). To effectuate this purpose, Rule X-16A-10 is adopted to exempt from Section 16(b) those transactions which need not be reported pursuant to the requirements of Section 16(a) and the rules adopted thereunder."

SEC Rule 16a-1 and Form 4 issued pursuant thereto set forth the persons who must report and the transactions which must be reported. Because of the interrelatedness of Sections 16(a) and 16(b) the reporting requirements of Section 16(a) are intended to cover all transactions which are subject to Section 16(b). This is so because the only practicable means of discovering violations of Section 16(b) is by examination of reports filed pursuant to the disclosure requirements of Section 16(a).

Consequently, following this Court's decision in the *Feder* case, the SEC in 1969 amended Rule 16a-1 to require reports from retired directors and officers in circumstances which might involve liability under Section 16(b) by reason of that decision. It did so in order that all transactions subject to Section 16(b) would have to be reported. This is shown by the Notice of Proposed Amendment to Rule 16a-1 (SEC Securities Exchange Act Release No. 8574 (April 17, 1969)) and the SEC notification of the adoption of the 1969 amendment (SEC Securities Exchange Act Release No. 8697 (September 18, 1969)). The latter Release stated:

> "The other amendment to the rule requires any person who has ceased to be a director or officer of a company, or who was a director or officer at the time the

company ceased to have equity securities registered pursuant to Section 12 of the Act, to file a report with respect to any change in beneficial ownership which occurs within 6 months after any change in such ownership which occurred prior to such cessation. Thus, one or more Form 4 reports will be required after the person ceases to be subject to such reporting requirements *only if and so long as transactions occur which are within 6 months of other transactions which occurred before he ceased to be so subject.*

"As indicated in Release No. 8574, the purpose of the amendments is to provide disclosure under Section 16(a) of the Act with respect to all transactions which may be subject to Section 16(b) of the Act." (Emphasis supplied)

Mr. Varnes' sales of Lilly stock on July 6, 1971 (14a) took place more than six months after December 22, 1970 when he made his last stock transaction before his retirement (13a). Therefore, those sales were exempted from reporting by SEC Rule 16a-1 and, accordingly, from Section 16(b) liability by SEC Rule 16a-10.

In *Levy* v. *Seaton*, 358 F.Supp. 1 (S.D.N.Y. 1973), the plaintiff commenced an action which in all material respects is identical to the instant case. In the *Seaton* case, Seaton had resigned as an officer of General Motors on August 31, 1970. At that time he owned an option to buy 2,151 shares of General Motors, which expired three months after his resignation. On November 24, 1970 Seaton sold 2,000 shares of General Motors stock and on November 27, 1970 exercised his option.

In granting Seaton summary judgment, Judge Gurfein held that Section 16(b) did not apply to the almost simultaneous purchase and sale, occurring after but within six months of Seaton's retirement. Since Seaton's purchase and sale had not occurred within six months of a transaction made while he was still an officer, Seaton was not required to report either the purchase or sale under SEC Rule 16a-1. Consequently, the court concluded

that the transaction was also exempted by SEC Rule 16a-10 from Section 16(b) liability.

The court below accepted the reasoning of the *Seaton* court and concluded that Mr. Varnes was similarly exempt from liability (20a).

Plaintiff does not challenge the validity of SEC Rule 16a-1 or SEC Rule 16a-10, but seeks to avoid their thrust by claiming that the former did not "specifically exempt" Mr. Varnes' sales from the reporting requirements of Section 16(a). (Pl. Br. 23). Although admitting Mr. Varnes had no obligation to report his sales (Pl. Br. 16, 23) plaintiff contends it was only because SEC Rule 16a-1 did not "affirmatively require" him to do so.

This distinction is without significance. Both the Supreme Court in *Reliance Electric Co.* v. *Emerson Electric Co., supra,* and the court in *Levy* v. *Seaton, supra,* have viewed the absence of a reporting requirement in Rule 16a-1 as an exemption.

In the *Reliance Electric Co.* case, the Court, referring to SEC Form 4, which is designated for filing purposes by SEC Rule 16a-1(a), concluded that the absence of an affirmative requirement that a former ten percent holder file reports indicated an exemption from reporting under Section 16(a). The Court noted (404 U.S. at 426):

> "Recognizing the interrelatedness of § 16(a) and § 16(b) of the Act, the Commission has used its power to grant exemptions under § 16(b) to exclude from liability any transaction that does not fall within the reporting requirements of § 16(a). A 10% owner is required by that section to report at the end of each month any changes in his holdings in the corporation during that month. The Commission has interpreted this provision to require a report only if the stockholder held more than 10% of the corporation's shares at some time during the month. Thus, a 10% owner who, like Emerson, sells down to 9.96% one month and disposes of the remainder the following month, would presumably be *exempt* from the reporting requirement and hence from § 16(b) under the

> SEC's own rules, without regard to whether he acquired the stock 'voluntarily.' " (Emphasis supplied)

And in *Levy* v. *Seaton, supra,* the court held that SEC Rule 16a-1 exempted Seaton's post-retirement transactions from the reporting requirements of Section 16(a). In this connection, the court stated (358 F. Supp. at 5):

> "The circumstance that he was not required to report exempts from Section 16(b) the transaction *exempted* from Section 16(a). SEC Rule 16a-10." (Emphasis supplied)

Plaintiff attempts to distinguish the *Seaton* case because Seaton was not required to report either his purchase or sale, while Mr. Varnes was exempted only from reporting his sales. The distinction is without merit because the exemption from reporting of Mr. Varnes' sales by itself precludes Section 16(b) liability. *Reliance Electric Co.* v. *Emerson Electric Co., supra,* 404 U. S. at 426.

POINT III

Mr. Varnes' sales were made in good faith in conformity with SEC regulations and were exempt from liability by reason of Section 23(a) of the Act.

Mr. Varnes is not liable under Section 16(b) for his post-retirement sales because those sales were made by him in good faith in conformity with SEC Rules 16a-1 and 16a-10. Section 23(a) of the Act precludes the imposition of liability under the substantive provisions of the Act for transactions undertaken in good faith reliance on SEC rules. That Section provides in pertinent part (15 U.S.C. § 78w(a)):

> "No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission or the Board of Governors of the Federal Reserve System, notwithstanding that such rule or regulation may, after

> such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason."

Mr. Varnes' sales come within this exculpatory language. As early as 1968 he had sought advice from Mr. Bradley, Lilly's General Counsel, concerning his obligations under Section 16(b) following retirement from office. In May, 1968, Mr. Varnes was advised in writing by Mr. Bradley that there was substantial doubt that Section 16(b) applied to any post-retirement transactions because SEC Rule 16a-10 exempts transactions exempted from reporting under Section 16(a), and post-retirement transactions need not be reported* (11a, Exh. 34).

Following the decision in the *Feder* case, Mr. Bradley, in April, 1969, sent a further memorandum to Mr. Varnes advising him of this Court's holding and that (11a, Exh. 35-36):

> "Section 16(b), of course, is not applicable unless one of the matching transactions (purchase or sale) was made at the time you were a director or officer of the company."

In March, 1970, Mr. Varnes received a third set of memoranda from Lilly's legal department (11a, Exh. 37-39). These memoranda by their terms were designed to inform those who "plan to retire as a director (or cease to be an officer of the company)" of the rules governing post-employment transactions. The March, 1970 memoranda again advised Mr. Varnes of the holding of the *Feder* case and also that the SEC had amended its rules to require the filing of a Form 4 only in the case of a purchase or sale within six months of a pre-retirement transaction. In this connection one of the memoranda stated (Exh. 38):

> "This reporting requirement continues so long as changes occur that are within six months of other changes that occurred before a person ceased to be a director or officer. *See*, Reg. 240.16a-1, attached."

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*Anticipating the possibility of this Court's holding in the *Feder* case, Mr. Bradley advised caution with respect to a post-retirement purchase or sale occurring within six months of a pre-retirement matching transaction (Exh. 34).

Mr. Varnes' understanding that he would not be subject to the provisions of Sections 16(a) and 16(b) of the Act for the sales in issue is manifested in his letter to the SEC in June, 1971 (14a, Exh. 44-46). There he states (Exh. 45):

> "It is my view and opinion that under the provisions of Section 16(a) and 16(b) profits may be recovered from any 'insider' only if a purchase and sale takes place within a six months period when either the purchase or sale of stock was at a time when the person was an officer or director . . ."

Finally, when SEC declined to issue any opinion, Mr. Varnes' personal attorney and Mr. Bradley, Lilly's general counsel, both concurred that the restrictions under Section 16(b) on the sale of Mr. Varnes' stock expired on June 22, 1971, six months after the last transaction in such stock made by Mr. Varnes prior to retirement. Mr. Varnes was so advised of that joint opinion (14a).

By reason of the information furnished him by his own and Lilly's counsel, Mr. Varnes was entitled to believe that he was exempt from Section 16(b) liability when he was no longer required to report his stock transactions. This occurred on June 23, 1971, more than six months after the last transaction before his retirement. Indeed, the parties have stipulated that Mr. Varnes would testify at a trial (15a):

> "Based on the memoranda and advice outlined above, I was of the opinion that § 16(a) and (b) of the Act and the pertinent SEC regulations permitted me to sell my Lilly stock after June 22, 1971 without any liability. My sales of July 6, 1971 resulted from that belief."

The immunity from liability for reliance on SEC rules provided by Section 23(a) of the Act has been the subject of a number of cases involving Section 16(b) and the exemption from coverage afforded by former SEC Rule 16b-3 (17 C.F.R. § 240.16b-3) for stock acquired pursuant to stock options. Although that rule was seriously questioned in *Greene* v. *Dietz*, 247 F.2d 689 (2d Cir. 1957), and held to be invalid in *Perlman* v. *Timberlake*, 172 F. Supp. 246 (S.D.N.Y. 1959), purchases and

sales made in reliance on that rule prior to the determination of its invalidity were immune from liability under Section 23(a) of the Act. *Greene* v. *Dietz, supra; Van Aalten* v. *Hurley*, 176 F. Supp. 851 (S.D.N.Y. 1959); *Perlman* v. *Timberlake, supra; Emerson Electric Manufacturing Co.* v. *O'Neill*, 168 F. Supp. 804 (E.D. Mo. 1958).

The purpose of exculpatory provisions such as Section 23(a) are explained in *Van Aalten* v. *Hurley, supra*, 176 F. Supp. at 855, as follows:

> "Exculpatory provisions of like purport are common in administrative statutes; they appear in the rule-making provisions of all the SEC legislation. Loss, Securities Regulation pp. 1097-1098 (1951). Their purpose is to broadly protect those who understandably rely upon the duly promulgated rule of an administrative agency, notwithstanding that such rule is thereafter invalidated. Such protection takes on increasing importance in this modern era when administrative bodies regulate so substantial a segment of our society, and is especially applicable to those cases where judges themselves entertain diverse views as to validity of a particular rule."

Mr. Varnes is entitled to the protection of Section 23(a). He did all that was reasonably possible to ascertain his obligations under the Act and its regulations and to act in accordance. "Good faith" under Section 23(a) requires no more. As the court in *Van Aalten* stated, 176 F. Supp. at 856:

> "The Court of Appeals for this Circuit, among others, rejected the view that '"good faith" must meet an objective standard of reasonableness', stating:
>
> > '"The "good faith" of the statute requires, we think, only an honest intention to ascertain what the * * * Act requires and to act in accordance with it.' Addison v. Huron Stevedoring Corp., 2 Cir., 204 F.2d 88, 93, certiorari denied, 1953, 346 U.S. 877, 74 S.Ct. 120, 98 L.Ed. 384."

Plaintiff claims (Pl. Br. 24) that reliance on the advice of counsel would not invoke the protection of Section 23(a). This argument, however, ignores the fact that the advice of counsel in this case included an explanation of the exemption provided by SEC Rule 16a-10 for transactions exempted from reporting under Section 16(a) and a notification that SEC Rule 16a-1 did not require a report for transactions occurring more than six months after the last transaction prior to retirement. Moreover, the protection of Section 23(a) is not limited only to members of the legal profession. It obviously extends as well to laymen who rely on their attorneys for the meaning of SEC regulations. Indeed in each of the cases cited above in which Section 23(a) was given effect, the defendant had received advice from the attorneys for the corporation of which he was a director or officer or from his personal attorney or both.

POINT IV

SEC Rule 16b-6 is a valid exercise of SEC power.

Plaintiff challenges the validity of SEC Rule 16b-6 on a number of grounds. The short answer to plaintiff's contentions is that all of them have been previously rejected by this Court in *Kornfeld* v. *Eaton*, 327 F.2d 263 (2d Cir. 1964), which upheld the validity of SEC Rule 16b-6.* There is nothing in plaintiff's brief (Pl. Br. 24-36) to suggest that his arguments are any more valid today than they were at the time of the *Kornfeld* decision.**

In any event, even absent SEC Rule 16b-6 the amount in issue in this case would be substantially less than the sum claimed by plaintiff and even less than the amount in issue under Rule 16b-6. This is so because Section 16(b) reaches only

*The appellant in the *Kornfeld* case was also represented by plaintiff's attorney here, which accounts for the similarity of contentions in the two cases.

**Although noting this Court's decision in the *Kornfeld* case, the court below did not rule upon plaintiff's contentions concerning Rule 16b-6 because of its holding on liability (20a).

"profit realized . . . from any purchase and sale, or any sale and purchase . . . within any period of less than the six months". The Section is designed to extract improper short-swing profits derived from the misuse of inside information. It is not designed to confiscate compensation paid an officer and director in the form of long-term appreciation in the value of stock realizable through the exercise of stock option grants.

Plaintiff's theory of damages presupposes that absent SEC Rule 16b-6 the measure of recovery is the difference between the exercise price of the employee's stock option and the sales price of the stock. This theory assumes that an employee gives no consideration for his stock options. This assumption is wrong in principle as well as on the facts of this case.

Employee stock options are "a form of compensation paid to employees in connection with successful present and future business performance", *Luckman* v. *C.I.R.*, 418 F. 2d 381, 384 (7th Cir. 1969). The value of the services performed in exchange for the options represents an additional cost to the employee who usually must forego the opportunity for other more lucrative engagements as part of the price. In the instant case, the grants to Mr. Varnes of his stock options carried with them a correlative obligation to perform services for a two-year period, at such compensation as Lilly might reasonably determine (10a, Exh. 5, 12, 19, 27).

It is no part of the purpose of Section 16(b) to deprive an officer or director of his compensation for services rendered except to the extent a violation results in short-swing profits. Consequently, in the case of a sale of stock obtained pursuant to the previous exercise of employee stock option grants a rule which computes profits by the lowest market price for six months prior to the date of sale would fully meet the objectives of the statute. Applying that test the lowest price of Lilly shares for six months prior to Mr. Varnes' sales was $103.62 on January 6, 1971 (213 The Commercial and Financial Chronicle 79 (January 11, 1971)), $3.62 more than the price required by SEC Rule 16b-6.* *But cf. B. T. Babbitt, Inc.* v. *Lachner*, 332 F.2d 255 (2d Cir. 1964) (where the Court used the fair market price of the stock when the option was first exercisable, resulting in a higher price than the price six months before sale).

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*This Court may take judicial notice of market quotations of stock. *Park & Tilford, Inc.* v. *Schulte*, 160 F.2d 984, 990 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947).

Conclusion

Mr. Varnes went to extraordinary lengths to avoid even the hint of any impropriety in connection with his stock transactions. At every point the advice he received from Lilly's counsel and his own was that Section 16(b) and the SEC rules permitted a retired director and officer to sell stock free of the restrictions of the statute six months after the last transaction before his retirement. That advice was accurate. To extend the drastic coverage of Section 16(b) to sales such as those made by Mr. Varnes would, in the words of the *Seaton* court, "make of a harsh rule an unfair one." The judgment appealed from should be affirmed in all respects.

Respectfully submitted,

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August 30, 1974

STATUTES AND RULES

SECURITIES EXCHANGE ACT OF 1934

Section 16(a) (15 U.S.C. § 78 p(a) (1970))

Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title, or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

Section 16(b) (15 U.S.C. § 78 p(b) (1970))

For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such

transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

Section 23(a) (11 U.S.C. § 78w(a) (1970))

The Commission and the Board of Governors of the Federal Reserve System shall each have power to make such rules and regulations as may be necessary for the execution of the functions vested in them by this title, and may for such purpose classify issuers, securities, exchanges, and other persons or matters within their respective jurisdictions. No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission of the Board of Governors of the Federal Reserve System, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

SEC RULES

Rule 16a-1(a) and (e) (17 C.F.R. § 240.16a-1(a) and (e))

(a) Initial statements of beneficial ownership of equity securities required by section 16(a) of the Act shall be filed on

Form 3. Statements of changes in such beneficial ownership required by that section shall be filed on Form 4. All such statements shall be prepared and filed in accordance with the requirements of the applicable form.

(e) Any person who has ceased to be a director or officer of an issuer which has equity securities registered pursuant to section 12 of the Act, or who is a director or officer of an issuer at the time it ceased to have any equity securities so registered, shall file a statement on Form 4 with respect to any change in his beneficial ownership of equity securities of such issuer which shall occur on or after the date on which he ceased to be such director or officer, or the date on which the issuer ceased to have any equity securities so registered, as the case may be, if such change shall occur within 6 months after any change in his beneficial ownership of such securities prior to such date. The statement on Form 4 shall be filed within 10 days after the end of the month in which the reported change in beneficial ownership occurs.

Rule 16a-10 (17 C.F.R. § 240.16a-10)

Any transaction which has been or shall be exempted by the Commission from the requirements of section 16(a) shall, insofar as it is otherwise subject to the provisions of section 16(b), be likewise exempted from section 16(b).

Rule 16b-6(a), (b) and (f) (17 C.F.R. § 240.16b-6(a), (b) and (f))

(a) To the extent specified in paragraph (b) of this rule the Commission hereby exempts as not comprehended within the purposes of section 16(b) of the Act any transaction or transactions involving the purchase and sale or sale and purchase of any equity security where such purchase is pursuant to the exercise of an option or similar right either (1) acquired more than 6 months before its exercise, or (2) acquired pursuant to the terms of an employment contract entered into more than 6 months before its exercise.

(b) In respect of transactions specified in paragraph (a) the profits inuring to the issuer shall not exceed the difference be-

tween the proceeds of sale and the lowest market price of any security of the same class within 6 months before or after the date of sale. Nothing in this rule shall be deemed to enlarge the amount of profit which would inure to the issuer in the absence of this rule.

(f) The exemption granted pursuant to this rule shall apply to any liability under section 16(b) existing at or after the effective date of this rule, but shall not be deemed to affect judgments rendered prior to that date.

Two (2) copies
received this
30th day of August, 1974
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atty for Appellant

Service of three (3) copies of the within
is hereby admitted this day of
19 .

Norman C. Sweeney
Attorney for,
Eli Lilly and Company

Service of three (3) copies of the within
is hereby admitted this day of
19 .

Attorney for,